Economic Outlook

12/1/87 B4750-2

Irving Trust

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Economic Research &
Planning Division

November 1987

Despite the volatility in financial markets, the real economy continues to show substantial strength. Adding to the outlook for further expansion is the improving composition of growth. Over the past year, growth in exports and business investment has picked up sharply, while consumption and Federal government spending have grown at about half the overall GNP rate. The real economy is contributing significantly to the long-awaited improvement in the twin deficits--budget and trade.

Real Growth

3Q 1986 - 3Q 1987
percent change

Consumption	1.6
Federal Government Spending	1.7
State & Local Government Spending	3.0
Total GNP	3.0
Private Domestic Investment	4.9
Net Exports	14.7

The October labor market statistics show the economy off to a very strong start in the fourth quarter. The manufacturing sector, where export business is strong, is likely to move into a full-fledged boom over the next few months. Factory overtime has reached levels last seen in the mid-1970s and the recent further depreciation of the dollar is likely to add even more stimulus. This heightens the prospects for increased inflation down the road. Industry has less slack capacity than it had during the first wave of dollar depreciation.

The main uncertainty in the outlook is the impact of the recent stock market decline on economic activity, especially consumption. Stock market declines can hurt the economy in two basic ways. They can cause a general confidence crisis leading most consumers and businesses to be extremely cautious in their spending and production plans. This is only likely to happen if there is a general liquidity crisis, like in the 1930s. The Federal Reserve's aggressive action has averted such a crisis for now. A second channel of stock market influence is what economists call the "wealth effect." Households, feeling poorer when share values decline, reduce consumption and increase saving, thus slowing down the economy.

The wealth effect from the recent stock market decline is likely to be quite small for a couple of reasons. First, the wealth lost was very short-lived; households still have almost as much stock market wealth as they did late last year. What they have lost are this year's gains, which are unlikely to have been fully incorporated into future spending plans. Second, the wealth effect is highly concentrated in upper income groups (See table). As income increases, households are more likely to own stock, own larger amounts, and hold stocks as a larger share of their overall portfolio. Almost 90% of households own little if any stock directly ($5,000 or less).

Distribution of Share Ownership

Income (percentile)	Own Stock (percent)	Share of Portfolio (percent)
0-90	15	N.A.
90-98	47	10
98-99	61	17
99-99.5	75	19
99.5-100	90	20

Thus the real damage is focused in the top income decile. These people will cut back on some upscale consumption items, settling for a Cadillac instead of a Jaguar, or an Aspen ski vacation instead of the Alps, but the effect on the economy will be small. Also, as the example suggests, luxury imports are likely to decline disproportionately, helping to shrink the trade deficit. First indications from car sales data support this expectation, as the sharpest declines were in European luxury imports. Post-October 19 consumer surveys show some decline in consumer confidence, but nothing compared with earlier crises, like the gasoline lines and credit controls. Unless a general confidence crisis develops, a recession is extremely unlikely.

Robert T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual 1986 IV	Actual 1987 I	Actual 1987 II	Actual 1987 III	Forecast 1987 IV	Forecast 1988 I	Forecast 1988 II	Forecast 1988 III	Actual 1985-1986	Forecast 1986-1987	Forecast 1987-1988
Consumer Spending	0.3	-0.5	1.2	3.2	0.0	1.0	1.0	1.0	2.7	1.3	1.1
Business Investment	0.6	-1.9	1.3	2.5	0.6	0.6	0.6	0.6	-0.3	0.1	0.9
Residential Investment	0.1	-0.4	-0.2	0.0	0.0	-0.1	-0.1	-0.1	0.6	-0.0	-0.1
Change in Inventories*	-0.1	4.4	-1.6	-1.7	-0.1	0.8	0.5	0.2	0.0	0.1	-0.3
Net Exports	1.1	1.8	0.3	-0.6	2.0	0.8	0.9	0.5	-1.0	0.4	0.8
Government Purchases*	-0.5	1.0	1.5	0.4	0.5	0.5	0.6	0.5	0.9	0.8	0.8
Real GNP	1.5	4.4	2.5	3.8	3.0	3.6	3.4	2.7	2.9	2.7	3.2

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual 1986 IV	Actual 1987 I	Actual 1987 II	Actual 1987 III	Forecast 1987 IV	Forecast 1988 I	Forecast 1988 II	Forecast 1988 III	Actual 1985-1986	Forecast 1986-1987	Forecast 1987-1988
Nominal GNP	2.1	8.6	6.3	6.2	7.2	8.7	9.1	8.5	5.6	5.8	8.0
GNP Deflator	0.7	4.2	3.5	2.4	4.0	4.9	5.4	5.8	2.6	3.0	4.6
Corporate Profits After Tax#	-0.3	6.7	9.9	6.3	6.3	12.5	10.1	8.5	-1.0	7.3	9.5

Monthly Economic Indicators

	Recent Data Aug.	Recent Data Sept.	Recent Data Oct.	Actual 1986	Forecast 1987	Forecast 1988
Consumer Price Index** (%)	0.5	0.2	n.a.	1.1	5.2	6.1
Industrial Production (%)	0.3	0.2	n.a.	1.0	3.6	4.3
Retail Sales (%)	1.3	-0.4	n.a.	5.5	3.8	4.1
Auto Sales (million units, a.r.)	12.4	11.8	9.2	11.5	10.3	10.0
Housing Starts (million units, a.r.)	1.60	1.67	n.a.	1.81	1.65	1.58
Unemployment Rate (%)	6.0	5.9	6.0	7.0	6.2	5.6
Merchandise Trade Deficit ($ bn., a.r.)	-187.2	-169.0	n.a.	-156.2	-165.0	-135.0

*Adjusted for CCC purchases. **Annual percent changes are December to December.
#Quarterly data are year-over-year percent changes.
a.r.=annual rate F=Forecast

Economic Outlook

2/29/88 B4750-2

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Economic Research &
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December 1987

The continuing signs of economic strength since October have led many analysts to restore their higher pre-crash forecasts for economic growth in 1988. There is little evidence from surveys of consumers and businesses to suggest much impact from the stock market decline. While consumer confidence is lower, it still remains relatively high by historical standards and higher than it was last Christmas. This is not too surprising considering the November unemployment rate was down a full percentage point from the November 1986 level. There is not much evidence of a slowdown in recent business statistics either. Instead, measures of economic activity are suggesting the economy is still strong.

For example, payroll employment registered larger-than-expected gains in October and November. Initial claims for unemployment insurance remain at the lowest level in over 10 years. The Federal Reserve's "tan book" for the December FOMC meeting points to widespread strength in the economy as "most districts report overall economic expansion with particular strength noted in Boston, Chicago, Minneapolis, and San Francisco." According to the report, "The manufacturing sector has been a prime source of recent expansion in most districts." The continuing fast pace of manufacturing job growth also supports the Fed assessment, which is based on interviews and data gathered by each of the 12 Federal Reserve District banks. On a more troublesome note, the larger-than-expected October trade deficit was a setback for the transition to better balanced growth. Nevertheless, the sharp surge in imports is a definite sign of hefty demand in the U.S. economy.

Exports are growing as well, leading the nation's corporate purchasing managers to expect stronger economic growth in 1988. Their optimistic outlook is based on recent "significant increases in export business." The consensus in their mid-November semiannual survey expects this year's fourth quarter to be stronger than the third, and next year's first half to be stronger than the last half of 1987. The managers also see price increases picking up by about a half percent next year.

Some of the confusing crosscurrents in the economy are apparent in the motor vehicle markets. For example, November domestic car sales were off almost 7% compared with the same month in 1986. But year-end sales were relatively strong last year as buyers acted to take advantage of the sales tax deduction for the last time. Furthermore, when one adds in light truck sales, November sales were actually higher than last year. Over the past few years light trucks have comprised an increasing share of sales to consumers, as minivans and four-wheel drive vehicles have gained in popularity. These vehicles do not count as autos in the statistics. Strong employment is helping buoy vehicle sales, especially in manufacturing regions, where less of the population enjoyed the 1984-1986 consumer boom. Also supporting vehicle sales is the strong business sector, which buys a third of all automobiles and the majority of trucks. While consumer auto demand has moderated, businesses have been investing growing amounts in durable equipment, including autos and trucks.

Finally, the automobile import situation is interesting. While overall import sales were off about 3% in October and November compared with last year, luxury

imports were off by about 16%. This partly reflects the strength in luxury sales late last year, as high-income-tax bracket customers had stronger incentives to take advantage of the sales tax deduction before it ended. In addition, stiff price increases and the decline in stock prices probably account for some of the disproportionate hit to luxury imports. Unfortunately, the price increases could be large enough to offset the volume decline, leaving the nominal trade balance little improved, but unit import volume should slow as imported luxury car inventories build.

All in all, the motor vehicle sector illustrates the basic theme of the economic outlook: production continues to increase as consumption growth moderates and investment gains momentum. The main near-term risk is not recession, but excess inventory buildup if domestic and foreign demand is insufficient to absorb fast-rising output. An excess inventory buildup could eventually cause a recession. However, there is little evidence to date of widespread inventory excesses, and strong employment coupled with rising export demand should lead to a growing need to replenish inventories in many sectors rather than cutting them back. If demand persists at recent levels, producers will continue to invest to expand capacity, as more and more industries encounter production bottlenecks over the next year.

Robert T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual				Forecast				Actual	Forecast	
	1986	1987			1987			1988	1985-	1986-	1987-
	IV	I	II	III	IV	I	II	III	1986	1987	1988
Consumer Spending	0.3	-0.5	1.2	3.2	0.0	0.8	0.8	1.0	2.7	1.3	1.0
Business Investment	0.6	-1.9	1.3	2.8	1.5	0.6	0.6	0.6	-0.3	0.2	1.1
Residential Investment	0.1	-0.4	-0.2	-0.3	0.0	-0.1	-0.1	-0.1	0.6	0.0	-0.1
Change in Inventories*	-0.1	4.4	-1.6	-1.6	0.7	0.8	0.5	0.2	0.0	0.2	0.1
Net Exports	1.1	1.8	0.3	-0.2	1.0	0.8	0.9	0.7	-1.0	0.4	0.7
Government Purchases*	-0.5	1.0	1.5	0.2	0.5	0.5	0.5	0.5	0.9	0.7	0.5
Real GNP	1.5	4.4	2.5	4.1	3.7	3.4	3.2	2.9	2.9	2.8	3.3

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual				Forecast				Actual	Forecast	
	1986	1987			1987			1988	1985-	1986-	1987-
	IV	I	II	III	IV	I	II	III	1986	1987	1988
Nominal GNP	2.1	8.6	6.3	7.0	7.7	7.8	8.1	8.4	5.6	5.9	7.8
GNP Deflator	0.7	4.2	3.5	2.8	4.0	4.4	4.9	5.3	2.6	3.0	4.3
Corporate Profits After Tax#	-0.3	6.7	9.9	6.3	6.3	12.5	10.1	8.5	-1.0	7.3	9.5

Monthly Economic Indicators

	Recent Data			Actual	Forecast	
	Sept.	Oct.	Nov.	1986	1987	1988
Consumer Price Index** (%)	0.2	0.4	n.a.	1.1	4.8	6.0
Industrial Production (%)	-0.3	0.9	0.4	1.0	3.6	4.3
Retail Sales (%)	-1.7	-0.9	0.2	5.5	3.8	4.1
Auto Sales (million units, a.r.)	11.8	9.2	9.8	11.5	10.3	10.0
Housing Starts (million units, a.r.)	1.65	1.51	n.a.	1.81	1.66	1.53
Unemployment Rate (%)	5.9	6.0	5.9	7.0	6.2	5.5
Merchandise Trade Deficit ($ bn., a.r.)	-169.0	-211.6	n.a.	-156.2	-168.0	-135.0

*Adjusted for CCC purchases. **Annual percent changes are December to December. December 15, 1987
#Quarterly data are year-over-year percent changes.
a.r.=annual rate F=Forecast

Economic Outlook

2/12/88 B4750-2

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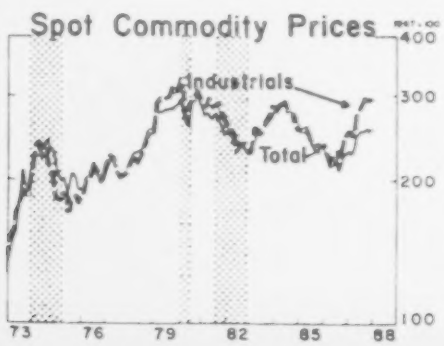
Economic Research & Planning Division

January 1988

Once again the markets have been surprised by stronger-than-expected employment growth. The healthy increase in December employment coming on top of the gains in the prior two months just about guarantees that fourth quarter GNP grew at well over a 3% rate. Christmas sales showed only a modest gain from a year ago in line with the slowdown in retail sales which has been evident since mid-1987. There appeared to be little additional impact from the stock market decline in October. Strong employment growth and lower interest rates since October have apparently more than offset whatever negative effect the stock market crash exerted on consumer spending. Consumption growth is being sustained at moderate levels by continued income growth. Aided by these higher income levels, the latest index of housing affordability compiled by the National Association of Realtors rose to its highest level in 10 years. The index shows that the median-income household currently has over 15% more income than is necessary to buy a median-priced home with conventional mortgage financing. This should help sustain 1988 housing starts.

The purchasing managers survey taken in December also confirms the underlying vigor of the business sector, showing "no apparent ill effects" from October's stock market plunge. Slower delivery times, higher materials prices, shortages of key materials, stronger orders, and declining inventories all point to almost boom conditions in the industrial sector. The December survey reported the strongest growth in production since 1983. Some analysts have dismissed the strong fourth quarter output gain in the U.S. as reflecting excess inventory buildup. If true, this would eventually force a production slowdown, as the unwanted inventories are worked off. But the purchasing managers survey contradicts this view, with the managers reporting difficulty building inventories up to the desired level as orders continue strong.

In addition to the good news on the employment front, the inflation news has been reassuring in recent months. For the fourth quarter as a whole, the producer price index for finished goods was actually down a bit. Food and energy price declines helped to keep the index down in December. This respite from the evidence of building inflationary pressure last summer is unlikely to last much longer. The prolonged dollar depreciation, labor market tightness, and fuller utilization of industrial capacity all point to fundamental pressure for higher prices down the road. To date, the clearest evidence of building inflationary pressures is in industrial commodity prices. Here double-digit increases have accompanied the U.S. industrial rebound since late 1986.



While overall inflation is likely to pick up somewhat, it will be to levels far below the double-digit ranges of the late 1970s. Instead, we expect consumer price inflation to move from the 4%-4.5% range of 1987 into the 5%-5.5% range by late 1988. The bottom line is that any slowdown in the economy will be from the unusually high growth level of 1987's second half. While a deceleration from over 4% growth to the 3%-3.5% GNP growth range would be a slowdown, it would still represent an above-average increase for the U.S. economy. A more pronounced slowdown does not seem to be in the cards. Two recent trends seem to be behind what we believe is a mistaken consensus view that economic growth will fall below 2.5% in 1988. One is the recent more moderate growth of domestic demand; the other is the recent strength in inventories. While these changes may reduce growth a bit, they do not seem sufficient to cause a dramatic slowdown. Surging exports are offsetting much of the decline in domestic demand growth. Above-average capital spending increases will also be necessary to expand diminishing excess capacity in many parts of the industrial sector. Undesired inventory accumulation of some retail and auto products is at least partly counterbalanced by lower-than-desired stocks in other sectors. The current situation is similar to last January when most economists were overly pessimistic about the prospects for 1987 growth. The economy seems poised again to surprise the experts with another year of better-than-expected growth.

Robert T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual				Forecast				Actual	Forecast	
	1986	1987			1987	1988			1985-	1986-	1987-
	IV	I	II	III	IV	I	II	III	1986	1987	1988
Consumer Spending	0.3	-0.5	1.2	3.5	0.0	0.8	0.8	1.0	2.7	1.3	1.0
Business Investment	0.6	-1.9	1.3	2.8	1.5	0.6	0.6	0.6	-0.3	0.2	1.1
Residential Investment	0.1	-0.4	-0.2	-0.4	0.0	-0.1	-0.1	-0.1	0.6	0.0	-0.1
Change in Inventories*	-0.1	4.4	-1.6	-1.5	0.6	0.8	0.5	0.2	0.0	0.2	0.2
Net Exports	1.1	1.8	0.3	-0.6	1.0	0.8	0.9	0.7	-1.0	0.3	0.6
Government Purchases*	-0.5	1.0	1.5	0.5	0.5	0.5	0.5	0.5	0.9	0.8	0.6
Real GNP	1.5	4.4	2.5	4.3	3.6	3.4	3.2	2.9	2.9	2.8	3.4

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual				Forecast				Actual	Forecast	
	1986	1987			1987	1988			1985-	1986-	1987-
	IV	I	II	III	IV	I	II	III	1986	1987	1988
Nominal GNP	2.1	8.6	6.3	7.3	7.7	7.9	8.1	8.4	5.6	6.0	7.8
GNP Deflator	0.7	4.2	3.5	2.8	4.0	4.4	4.9	5.3	2.6	3.0	4.4
Corporate Profits After Tax#	-0.3	6.7	10.0	9.0	6.3	12.5	10.1	8.5	-1.0	9.0	9.5

Monthly Economic Indicators

	Recent Data			Actual	Forecast	
	Oct.	Nov.	Dec.	1986	1987	1988
Consumer Price Index** (%)	0.4	0.3	n.a.	1.1	4.8	5.1
Industrial Production (%)	1.1	0.4	0.2	1.0	3.7	5.1
Retail Sales (%)	-0.9	0.1	0.7	5.5	3.4	3.4
Auto Sales (million units, a.r.)	9.2	9.8	10.9	11.5	10.3	9.8
Housing Starts (million units, a.r.)	1.52	1.64	n.a.	1.81	1.65	1.53
Unemployment Rate (%)	6.0	5.9	5.8	7.0	6.2	5.5
Merchandise Trade Deficit ($ bn., a.r.)	-211.6	-158.6	n.a.	-156.2	-171.0	-145.0

*Adjusted for CCC purchases. **Annual percent changes are December to December. January 19, 1988
#Quarterly data are year-over-year percent changes.
a.r.=annual rate F=Forecast

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4/1/88

Economic Outlook

Irving Trust

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Economic Research &
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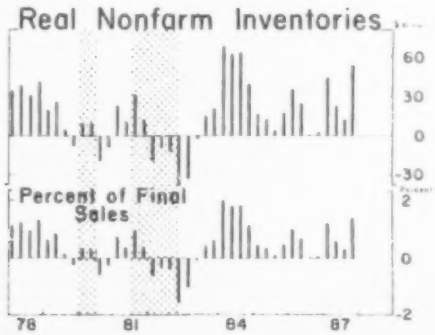
February 1988

Fourth-quarter GNP growth at 4.2% was well above market expectations. However, the increase was largely due to a surge in inventory investment, raising questions about the sustainability of future growth. Sluggish retail sales, rising claims for unemployment insurance, and a small increase in January payroll employment also point to slower growth ahead. Is the current slowdown a pause that refreshes, while stock market aftershocks subside? Or is it the beginning of a prolonged decline to recession? A closer look at the statistics suggests that the current signs of weakness are hardly sufficient to preclude continued expansion in 1988, especially later in the year. To the contrary, the current slowdown is likely to extend the expansion by prolonging a lower interest rate environment and deferring the buildup of inflationary pressures until later this year. Only then will monetary policy face a harder choice between further expansion and higher inflation.

A major contribution from inventories had been expected for the fourth quarter. Consumer and producer spending on motor vehicles surged in the third quarter as automobile producers launched major incentive programs to clear dealer lots for the new model year. Most of the inventory swing in the fourth quarter was in the motor vehicle sector as consumers and businesses slowed their purchases from the extraordinary pace of the third quarter. The slowdown in auto purchases was deepest in October, and sales have picked up to healthier levels since then.

The large fourth-quarter increase in nonfarm inventories followed a sluggish increase in the third quarter (see chart). A sharp slowdown in inventory investment this quarter will probably have a big negative impact on growth, but this should be offset by the pickup in sales from temporarily depressed levels. There is little reason to expect a longer-term slowdown. Recall that in the first quarter of 1987 inventories contributed a comparable amount to GNP growth, yet overall growth remained high in 1987. This earlier inventory buildup also followed a spike in auto sales.



Aside from motor vehicles, there does not appear to be much of an excess inventory problem. Nonauto manufacturers have inventories well under control. In the fourth quarter, nondurable goods inventory investment barely changed. This was true at the manufacturing, wholesale, and retail levels. While there may be pockets of inventory excess, the ratio of inventory to final sales is not out of line with normal levels in an expansion. Since the ratio is likely to go down in this quarter as sales outpace inventory investment, the economy

should be poised for faster expansion later in the year. Also helping to avoid a sharper domestic production slowdown are high levels of imported car inventories, which grew at a faster rate than domestic cars. Imports account for about a third of the recent growth in car inventories. Working these inventories down should help improve the trade deficit. So while inventories are likely to depress first-quarter growth, the problem is unlikely to persist beyond the current period.

Consumer confidence has risen recently from the lower levels that followed the stock market crash and remains in expansion territory. Business confidence appears to have been shaken a bit as managers making end-of-the-year changes seem to have responded to fears of a slowdown by laying off more workers and slowing hiring in January. But it is premature to conclude that this is a trend. The household employment survey showed a strong increase in January, the unemployment rate remained at the same low level, and the turn-of-the-year statistics are harder to fathom because of seasonal adjustment problems.

The outlook in most of the industrial sector is less murky. Continued strong new orders, lean inventories-to-sales ratios, and a building backlog of unfilled orders all point to continuing expansion. Export growth remains strong. Considerable new stimulus remains from the year-end dollar decline. Increasing capacity utilization rates should make capital spending an important source of growth this year. Weighing the signs of strength and weakness, the balance still comes down on the side of further expansion. Look for faster growth after the first quarter.

Robert T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual 1987 I	1987 II	1987 III	1987 IV	Forecast 1988 I	1988 II	1988 III	1988 IV	Actual 1986-1987	Forecast 1987-1988	Forecast 1988-1989
Consumer Spending	-0.5	1.2	3.5	-2.5	1.3	0.8	1.0	1.0	1.2	0.7	0.5
Business Investment	-1.9	1.3	2.8	-0.4	1.5	0.8	0.8	0.6	0.1	1.0	1.0
Residential Investment	-0.4	-0.2	-0.4	0.3	-0.1	-0.1	-0.1	-0.1	0.0	-0.1	-0.2
Change in Inventories*	4.4	-1.6	-1.5	5.5	-2.4	0.5	0.4	0.3	0.5	0.3	0.0
Net Exports	1.8	0.3	-0.6	0.8	1.2	0.9	0.7	0.9	0.3	0.7	0.6
Government Purchases*	1.0	1.5	0.5	0.5	0.5	0.5	0.5	0.5	0.8	0.6	0.4
Real GNP	4.4	2.5	4.3	4.2	2.0	3.4	3.3	3.2	2.9	3.2	2.3

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual 1987 I	1987 II	1987 III	1987 IV	Forecast 1988 I	1988 II	1988 III	1988 IV	Actual 1986-1987	Forecast 1987-1988	Forecast 1988-1989
Nominal GNP	8.6	6.3	7.3	6.7	5.7	8.0	8.9	9.1	5.9	7.2	8.5
GNP Deflator	4.2	3.5	2.8	2.6	3.5	4.5	5.3	5.7	2.9	3.8	6.1
Corporate Profits After Tax#	6.7	10.0	9.0	6.3F	12.5	10.1	8.5	6.9	9.0	9.5	6.0

Monthly Economic Indicators

	Recent Data Nov.	Dec.	Jan.	Actual 1987	Forecast 1988	Forecast 1989
Consumer Price Index** (%)	0.3	0.1	n.a.	4.4	5.3	6.2
Industrial Production (%)	0.4	0.2	n.a.	3.7	5.1	2.7
Retail Sales (%)	0.1	0.7	n.a.	3.4	4.4	5.2
Auto Sales (million units, a.r.)	9.8	10.9	n.a.	10.3	9.8	8.8
Housing Starts (million units, a.r.)	1.64	1.37	n.a.	1.64	1.53	1.35
Unemployment Rate (%)	5.9	5.8	5.8	6.2	5.5	5.5
Merchandise Trade Deficit ($ bn., a.r.)	-158.6	n.a.	n.a.	-173.0F	-145.0	-110.0

*Adjusted for CCC purchases. **Annual percent changes are December to December. February 10, 1988
#Quarterly data are year-over-year percent changes. F = Forecast
a.r. = annual rate

Economic Outlook

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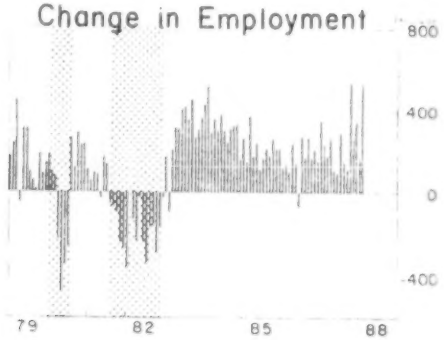
March 1988

The surge in February employment has given the strongest signal to date that reports of the economic expansion's imminent demise are greatly exaggerated (see chart). Combined with the large upward revision in January payroll employment, the latest jobs data virtually assure that output continues to grow in 1988. The 5.7% unemployment rate is the lowest since the summer of 1979. And initial claims for unemployment insurance have returned to less worrisome levels after a sharp run-up in January.



Even before the employment numbers were released, economists had begun to rethink their outlooks for 1988. For example, the February survey of the National Association of Business Economists found only one in four respondents believing a recession would begin in 1988, down from about half of those surveyed in November, shortly after the stock market crash. With the stock market debacle now almost five months behind us, it is increasingly unlikely that its lingering effects will precipitate a recession. Instead, the crash has had the fortuitous effect of dampening inflationary expectations, paving the way for lower interest rates and a prolonged expansion.

Recent evidence from the economy suggests that the interest rate breather may be drawing to a close. In addition to the strong employment data, other indicators have reduced recession fears. The fourth-quarter buildup in auto inventories appears to be working down with little evidence of consumer weakness. One recent estimate placed GM inventories at a 59 days' supply in late February, Chrysler at 68 days, and Ford at 59 days compared with a desired level of roughly 65 days. This was down from 84 days, 101 days, and 70 days' supply a month earlier at GM, Chrysler, and Ford, respectively. Indeed, domestic automobile production schedules are already picking up and will contribute to faster economic growth in the second quarter. What inventory problems remain are largely confined to foreign models. Some Japanese producers continue to pile up inventories in the U.S. just to assure their quotas won't be reduced when the new Japanese fiscal year begins April 1.

Fourth-quarter GNP growth was revised up to 4.5% from the 4.2% rate initially reported. Upward adjustments in domestic demand accounted for most of the increase with significant upward revisions reported in consumer and business spending. Unfortunately, this included increased spending on imports, while exports were revised down. All in all, the changes showed less weakness in final sales than the preliminary report.

The only real signs of weakness that remain are in the building sector where housing starts, housing sales, and construction spending were all down in January. Construction employment also fell in January, but rebounded sharply in February, suggesting some of the January weakness was due to worse than usual weather in certain areas of the country. While this sector is likely to remain sluggish, the January numbers most likely overstate the problem.

There are some signs of moderating growth in the manufacturing sector. Employment gains in January and February were less than half the monthly average in the last several months of 1987. The manufacturing workweek and overtime measures declined, but remain relatively high by historical standards. The February Purchasing Managers' index slipped a bit, but still points to continued expansion. The growth in production was described as "strong" but "decidedly slower" than it was in the fourth quarter of 1987, when the index reached its highest levels. January new factory orders showed good strength after adjustment for the volatile transportation sector, and the backlog of unfilled orders is still rising.

In sum, the economy continues to defy the gloomsters. While there are incipient signs of moderating growth in the manufacturing sector, this is simply a slowdown from unsustainable levels. The overall economy remains healthy. Job growth is keeping consumer confidence at high levels. Recent employment gains have been especially strong in higher paying executive, managerial, and administrative jobs. The outlook remains favorable for good growth in 1988.

Robert T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual 1987				Forecast 1988				Actual 1986-	Forecast 1987-	Forecast 1988-
	I	II	III	IV	I	II	III	IV	1987	1988	1989
Consumer Spending	-0.5	1.2	3.5	-2.0	1.5	0.8	0.8	0.8	1.2	0.8	0.5
Business Investment	-1.9	1.3	2.8	-0.1	1.7	0.8	0.8	0.6	0.1	1.1	1.0
Residential Investment	-0.4	-0.2	-0.4	0.4	-0.1	-0.1	-0.1	-0.1	0.0	0.0	-0.2
Change in Inventories*	4.4	-1.6	-1.5	5.4	-2.2	0.5	0.4	0.3	0.5	0.3	0.0
Net Exports	1.8	0.3	-0.6	0.2	1.1	0.9	0.7	0.9	0.3	0.6	0.6
Government Purchases*	1.0	1.5	0.5	0.6	0.5	0.5	0.5	0.5	0.8	0.6	0.4
Real GNP	4.4	2.5	4.3	4.5	2.5	3.4	3.1	3.0	2.9	3.4	2.3

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual 1987				Forecast 1988				Actual 1986-	Forecast 1987-	Forecast 1988-
	I	II	III	IV	I	II	III	IV	1987	1988	1989
Nominal GNP	8.6	6.3	7.3	7.3	6.0	8.0	8.7	8.9	6.0	7.3	8.5
GNP Deflator	4.2	3.5	2.8	2.7	3.5	4.5	5.3	5.7	3.0	3.8	6.1
Corporate Profits After Tax#	6.7	10.0	9.0	6.3F	12.5	10.1	8.5	6.9	9.0	9.5	6.0

Monthly Economic Indicators

	Recent Data			Actual	Forecast	
	Dec.	Jan.	Feb.	1987	1988	1989
Consumer Price Index** (%)	0.1	0.3	n.a.	4.4	5.3	6.2
Industrial Production (%)	0.4	0.2	n.a.	3.7	5.1	2.7
Retail Sales (%)	1.2	0.5	n.a.	3.5	3.4	3.2
Auto Sales (million units, a.r.)	10.9	10.4	n.a.	10.3	9.8	8.8
Housing Starts (million units, a.r.)	1.40	1.38	n.a.	1.63	1.53	1.35
Unemployment Rate (%)	5.8	5.8	5.7	6.2	5.5	5.5
Merchandise Trade Balance ($ bn., a.r.)	-146.4	n.a.	n.a.	-171.2	-145.0	-110.0

*Adjusted for CCC purchases. **Annual percent changes are December to December. March 8, 1988
#Quarterly data are year-over-year percent changes. F = Forecast
a.r. = annual rate

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4/26/88

Economic Outlook

Irving Trust

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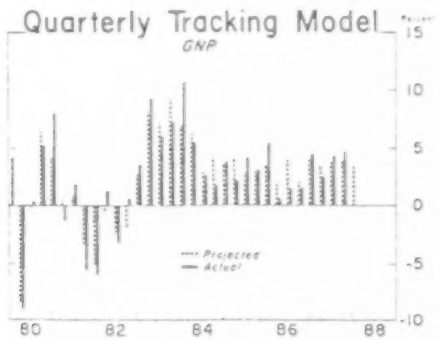
Economic Research &
Planning Division

April 1988

The March employment data confirm that the economy continues to grow moderately in 1988. Employment data are the earliest comprehensive indicators of aggregate economic activity. Our statistical tracking model of quarterly GNP growth is dominated by the effect of growth in the index of aggregate hours worked. This model predicts GNP growth of about 3 1/2% for the first quarter, down quite a bit from the fourth quarter, but far above most economists' predictions, especially earlier in the year (See chart). Because of the huge inventory correction in the first quarter, the employment data may overstate output growth in the first quarter. Adjusting for this inventory effect, our official estimate is for 3% growth, when the Commerce Department announces the number late this month.



The inventory buildup from late last year is just about gone now. Most of the excess was in the motor vehicle sector. In March, motor vehicle industry employment rose for the first time in five months. Producers have raised their production plans for the second quarter and GM is reporting inventories of many models are too low now. Needless to say, sales have exceeded expectations. Light truck sales and production are particularly strong. Production gains in the motor vehicle sector will bolster GNP in the second quarter.

Construction employment has also been surprisingly robust recently. The aggregate hours index in that industry grew at a double-digit annual rate in the first quarter, suggesting recent declines in construction spending are about to be reversed. The pickup in construction activity probably partly reflects strength in business investment. Capacity utilization rates in a number of industries suggest businesses will need to increase new plant expenditures to keep pace with the economic expansion. The backlog of unfilled orders for capital goods has continued to grow rapidly this year, indicating manufacturers are having trouble keeping up with orders in a timely fashion. The March purchasing managers' report showed a rebound in new order growth. The managers also reported a continued slowdown in vendor delivery times. In addition, they noted a trend toward extended lead times for placing orders "reflecting efforts to combat persistent shortages in selected commodities." Machine tool orders are running at about double last year's sluggish pace.

Finally, manufacturing employment growth has dropped off sharply this year. Rather than a sign of weakness, this is probably an indication of the tightened capacity situation. Last year, as export orders rocketed, manufacturers recovered from the sluggish 1984-1986 period, when the high dollar was hurting U.S. industry. As industry recovered last year, employment growth in manufacturing surged. But this is typical in an early recovery phase, when there is plenty of slack capacity. Now, more and more industries are approaching full capacity and additional workers can only be added if new plant and equipment spending brings on new capacity. Since export orders are still strong according to the purchasing managers, 1988 is likely to be a year of strong capital spending and increasing price pressures as businesses pay a premium to get faster deliveries.

Overall the economy is performing admirably. The biggest risk to continued expansion is a financial market crisis. As the consensus view has shifted away from the danger of recession to fears of inflation, interest rates have risen and the Fed appears to have tightened monetary policy slightly. Better-than-expected economic growth raises the possibility that import growth will not slow down as much as the foreign exchange markets would like. This makes the dollar more vulnerable. Because economic growth is turning out to be faster than expected in other countries as well, it is increasingly unlikely that central banks abroad will cut their rates to help the dollar. This raises the chances of higher rates here to support the dollar.

Robert T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual 1987				Forecast 1988				Actual 1986-1987	Forecast 1987-1988	Forecast 1988-1989
	I	II	III	IV	I	II	III	IV			
Consumer Spending	-0.5	1.2	3.5	-1.7	2.0	0.8	0.8	0.8	1.3	1.0	0.5
Business Investment	-1.9	1.3	2.8	0.2	2.0	0.8	0.8	0.6	0.1	1.3	1.0
Residential Investment	-0.4	-0.2	-0.4	0.4	-0.1	-0.1	-0.1	-0.1	0.0	-0.1	-0.2
Change in Inventories*	4.4	-1.6	-1.5	4.9	-2.2	0.4	0.3	0.2	0.4	0.2	0.0
Net Exports	1.8	0.3	-0.6	0.3	0.8	0.9	0.7	0.9	0.3	0.5	0.6
Government Purchases*	1.0	1.5	0.5	0.7	0.5	0.5	0.5	0.5	0.8	0.6	0.4
Real GNP	4.4	2.5	4.3	4.8	3.0	3.3	3.0	2.9	2.9	3.5	2.3

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual 1987				Forecast 1988				Actual 1986-1987	Forecast 1987-1988	Forecast 1988-1989
	I	II	III	IV	I	II	III	IV			
Nominal GNP	8.6	6.3	7.3	7.3	6.4	7.9	8.5	8.7	6.0	7.4	8.5
GNP Deflator	4.2	3.5	2.8	2.7	3.5	4.5	5.3	5.7	3.0	3.8	6.1
Corporate Profits After Tax#	6.7	10.0	9.0	7.6	12.5	10.1	8.5	6.9	8.4	9.5	6.0

Monthly Economic Indicators

	Recent Data			Actual	Forecast	
	Jan.	Feb.	Mar.	1987	1988	1989
Consumer Price Index** (%)	0.3	0.2	n.a.	4.4	5.3	6.2
Industrial Production (%)	0.3	0.2	n.a.	3.7	5.1	2.7
Retail Sales (%)	0.0	0.4	n.a.	5.1	5.4	5.2
Auto Sales (million units, a.r.)	10.4	11.0	10.7	10.3	9.8	8.8
Housing Starts (million units, a.r.)	1.37	1.49	n.a.	1.63	1.53	1.35
Unemployment Rate (%)	5.8	5.7	5.6	6.2	5.5	5.5
Merchandise Trade Balance ($ bn., a.r.)	-149.2	n.a.	n.a.	-171.2	-145.0	-110.0

*Adjusted for CCC purchases. **Annual percent changes are December to December. April 7, 1988
#Quarterly data are year-over-year percent changes.
a.r. = annual rate

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Economic Outlook

Irving Trust

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Economic Research &
Planning Division

May 1988

The economic expansion continues to roll along, creating new jobs and pushing unemployment down. At 5.4%, unemployment now stands at its lowest level in fourteen years. The first quarter pattern of GNP growth set the stage for a solid second quarter. Earlier concerns about excessive inventory cutting into future production were exaggerated. While consumer spending is likely to moderate from its strong first quarter rebound, the capital goods and export boom should add enough additional momentum to keep the economy growing at a healthy pace. Strength in these sectors will also help sustain the expansion by adding needed capacity and restoring a better balance in U.S. external accounts. Nevertheless, inflation pressures are building in the U.S. and elsewhere as aggregate demand strains capacity in more industries and the labor market continues to tighten.

Total consumer spending was very strong in the first quarter, largely reflecting a surge in automobile purchases, after a steep decline in last year's final quarter. Increased spending on services also made an important contribution to first quarter growth with health services among the fastest growing segments in the economy. An aging population and a continuing trend toward medical treatment for psychological and substance abuse problems account for the strength in health services. These are long run trends that are likely to continue. The skyrocketing demand for medical services has kept services inflation much higher than inflation in other sectors and health benefit costs to employers are reflecting this pressure, rising in significance as part of overall labor costs. This is also an area where employment growth is most rapid. On the negative side, consumer purchases of nondurable goods slipped for the fourth quarter in a row and currently show little sign of reviving. While the real value of consumer spending on food, clothing, gasoline, and other nondurable goods is weak, the nominal or dollar level of spending has been growing, leading some analysts to suspect price discounting is not being adequately reflected in the GNP statistics. In any event, consumer spending is likely to continue on the modest growth path it has followed the past several months, when adjusted for sharp quarter-to-quarter swings in auto purchases. Strength in services and durables should be sufficient to offset weak nondurable goods consumption. The strong labor market will keep consumer confidence and spending from fading any time soon.

Business spending is making a significant contribution to economic growth. Over the past year, purchases of producer durable equipment grew around twenty percent. Capital goods industries showed strong employment growth in April and the backlog of unfilled orders for durable goods continues to mount. Factory hours, overtime, and earnings all showed solid increases in April. Increased car production schedules are also helping to boost second quarter output. Domestic auto inventories slimmed down considerably during the first quarter and entered the spring season at or below desired levels. Business services is another fast growing

sector with computer and personnel services leading the way. Nonfarm inventories increased quite a bit in the first quarter as large declines in retail inventories, especially cars, were more than offset by big gains in manufacturing and wholesale inventories. Closer scrutiny shows a normal build-up of machinery and other durable goods inventories as activity in this area has heated up. With large order backlogs, there is little danger that these stocks will prove excessive.

The strength in demand for capital goods has stimulated imports of durable equipment because many producers rely on international sources. Unfortunately, this hurts the trade deficit. However, imports of automobiles are dropping now as bloated inventories and shifts to U.S. production facilities slow the huge inflow of foreign automobiles. This will mitigate the impact of increased capital goods imports. Inventories of imported cars, unlike domestic cars, continued to build through the first quarter to record levels. Also helping the trade picture is the continuing surge in nonagricultural merchandise exports which grew about twenty percent over the past year.

All in all, the latest statistics confirm a picture of an economy in the late phases of economic expansion with shrinking margins of excess capacity outside the auto industry and a diminishing supply of unemployed workers to fill the jobs created by continued expansion. Unless domestic demand tapers off, inflation is likely to show further acceleration as the year progresses.

Robert T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual				Forecast				Actual	Forecast	
	1987			1988	1988			1989	1986-	1987-	1988-
	II	III	IV	I	II	III	IV	I	1987	1988	1989
Consumer Spending	1.2	3.5	-1.7	2.4	0.7	0.7	0.7	0.4	1.3	1.1	0.5
Business Investment	1.3	2.8	0.2	2.4	1.5	1.0	0.6	0.6	0.1	1.5	1.0
Residential Investment	-0.2	-0.4	0.4	-0.5	0.1	-0.1	-0.1	-0.2	0.0	-0.1	-0.2
Change in Inventories*	-1.6	-1.5	4.9	-1.9	-0.3	0.3	0.3	0.5	0.4	0.1	0.0
Net Exports	0.3	-0.6	0.3	0.4	1.1	1.0	0.9	0.8	0.3	0.5	0.6
Government Purchases*	1.5	0.5	0.7	-0.5	0.5	0.5	0.5	0.5	0.8	0.3	0.4
Real GNP	2.5	4.3	4.8	2.3	3.6	3.4	2.9	2.6	2.9	3.4	2.3

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual				Forecast				Actual	Forecast	
	1987			1988	1988			1989	1986-	1987-	1988-
	II	III	IV	I	II	III	IV	I	1987	1988	1989
Nominal GNP	6.3	7.3	7.3	4.7	8.1	9.0	8.7	8.7	6.0	7.1	8.5
GNP Deflator	3.5	2.8	2.7	2.4	4.5	5.3	5.7	6.0	3.0	3.5	6.1
Corporate Profits After Tax#	10.0	9.0	8.7	12.5F	10.1	8.5	6.9	6.4	8.7	9.5	6.0

Monthly Economic Indicators

	Recent Data			Actual	Forecast	
	Feb.	Mar.	April	1987	1988	1989
Consumer Price Index** (%)	0.2	0.5	n.a.	4.4	5.3	6.2
Industrial Production (%)	0.0	0.1	n.a.	3.7	5.1	2.7
Retail Sales (%)	0.6	0.8	n.a.	5.1	5.4	5.2
Auto Sales (million units, a.r.)	11.0	10.7	10.5	10.3	10.1	8.8
Housing Starts (million units, a.r.)	1.51	1.54	n.a.	1.63	1.53	1.35
Unemployment Rate (%)	5.7	5.6	5.4	6.2	5.5	5.5
Merchandise Trade Balance ($ bn., a.r.)	-165.9	n.a.	n.a.	-171.2	-145.0	-110.0

*Adjusted for CCC purchases. **Annual percent changes are December to December. May 9, 1988
#Quarterly data are year-over-year percent changes. F = Forecast
a.r. = annual rate

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Economic Outlook

Irving Trust

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June 1988

The basic pattern of economic growth continues unchanged from 1987. In late 1986, the U.S. economy shifted away from consumer-led growth to export and investment-led growth (Table). Recent statistics point to more of the same for the balance of 1988. Employment statistics for April and May suggest second quarter GNP growth in the 3 1/2 - 4% range, roughly maintaining the 4% average of the prior five quarters. The latest purchasing managers' reports also point to good second quarter growth.

Contribution to Real GNP Growth
Percent Annual Rate

	Actual 84II-86IV	Actual 86IV-88I	Forecast 88I-89I
Consumer	2.6	1.1	1.0
Investment	0.2	0.9	0.9
Residential	0.3	-0.2	-0.2
Inventory	-0.7	0.8	0.3
Net Exports	-0.7	0.7	0.7
Government	0.9	0.7	0.3
Total	2.6	4.0	3.0

Consumer spending is contributing less than half as much to GNP growth as it did in the 1984-1986 period, when the industrial sector was in the doldrums (Table). Many economists think even the current modest growth in consumer spending is unsustainable because of heavy debt loads and inadequate real income gains. But the Great American Job Machine is still chugging along and in May the Conference Board index of consumer confidence reached its highest level since 1969. Real incomes are picking up again as overtime and faster wage growth in a tight labor market outpace inflation. One risk to our outlook for a modest deceleration in growth is that the consumer sector may gather steam as the year progresses and the job market heats up.

Business investment is running full speed ahead, adding about as much to GNP growth as the much bigger consumer sector. The backlog of unfilled orders for durable goods is still building at double-digit rates, virtually guaranteeing several more months of strong production. Aside from the producer durable equipment category, which has been strong for quite a while, construction spending on industrial plant is up almost forty percent over the last year, showing a whopping 8.8% rise in April alone. In fact, the May Commerce Department survey found businesses plan to spend almost 12% more on plant and equipment in 1988 than in 1987. Capital spending plans for 1988 have been revised upward in successive surveys, as a better than expected economy fuels business confidence. The previous Commerce survey, taken just a few months earlier, suggested capital spending would grow about 8% in 1988. These developments are in line with the strong contribution we expect from investment as the year unfolds. The need for additional industrial capacity should feed this trend for quite a while.

Surging exports are feeding the trend as well. Real merchandise exports were up 25% over the last year, showing further acceleration in the first quarter. While import growth is likely to remain positive in this solid economic environment, the trade sector should still add significantly to economic growth as it has for over a year. Grain exports at much higher prices may also help the nominal trade deficit improve.

One surprise in the first quarter GNP numbers was the continued high level of inventory investment. Despite a steep decline in domestic car inventories, overall inventories were up substantially, as capital equipment and primary metals moved through the production pipeline. Huge order backlogs and healthy capital goods demand will sustain high inventory levels, but inventory growth should moderate as stocks approach desired levels. The drop in car inventories and buoyant sales have boosted car production, which will make an important contribution to second quarter growth.

The primary concern over the next several months will be inflation. Interest rate increases to date are unlikely to have much impact in a robust business environment with confidence quite high. Various inflation indicators have risen in the first half of 1988 and it is not likely they will decline on a sustained basis until the U.S. and world economy cool off some. As a result, the bias in financial markets will be toward higher interest rates. Preemptive monetary tightening seems unlikely, however, with the world's monetary authorities showing a clear preference for gradual restraint in 1988. The result will be continued economic expansion with inflation drifting higher.

Robert T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual				Forecast				Actual	Forecast	
	1987			1988	1988			1989	1986-	1987-	1988-
	II	III	IV	I	II	III	IV	I	1987	1988	1989
Consumer Spending	1.2	3.5	-1.7	2.8	1.6	1.1	0.8	0.6	1.3	1.5	0.5
Business Investment	1.3	2.8	0.2	2.3	1.6	0.9	0.8	0.4	0.1	1.5	1.0
Residential Investment	-0.2	-0.4	0.4	-0.5	-0.1	-0.1	-0.1	-0.2	0.0	-0.2	-0.2
Change in Inventories*	-1.6	-1.5	4.9	-2.2	0.1	0.3	0.4	0.5	0.4	0.1	0.0
Net Exports	0.3	-0.6	0.3	1.7	0.4	0.7	0.7	0.8	0.3	0.7	0.6
Government Purchases*	1.5	0.5	0.7	-0.2	0.3	0.3	0.3	0.3	0.8	0.3	0.4
Real GNP	2.5	4.3	4.8	3.9	3.9	3.2	2.9	2.4	2.9	3.9	2.3

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual				Forecast				Actual	Forecast	
	1987			1988	1988			1989	1986-	1987-	1988-
	II	III	IV	I	II	III	IV	I	1987	1988	1989
Nominal GNP	6.3	7.3	7.3	5.4	8.3	8.1	8.4	8.0	6.0	7.2	8.5
GNP Deflator	3.5	2.8	2.7	1.7	4.0	4.8	5.2	5.5	3.0	3.2	6.1
Corporate Profits After Tax#	10.0	9.0	8.7	13.5	10.0	8.5	6.9	6.4	8.7	9.3	6.4

Monthly Economic Indicators

	Recent Data			Actual	Forecast	
	Mar.	Apr.	May	1987	1988	1989
Consumer Price Index** (%)	0.5	0.4	n.a.	4.4	5.3	6.2
Industrial Production (%)	0.2	0.7	n.a.	3.7	5.1	2.7
Retail Sales (%)	1.7	-0.6	n.a.	5.1	5.4	5.2
Auto Sales (million units, a.r.)	10.7	10.5	10.2	10.3	10.3	8.8
Housing Starts (million units, a.r.)	1.55	1.56	n.a.	1.63	1.50	1.35
Unemployment Rate (%)	5.6	5.4	5.6	6.2	5.5	5.5
Merchandise Trade Balance ($ bn., a.r.)	-117.0	n.a.	n.a.	-171.2	-145.0	-110.0

*Adjusted for CCC purchases. **Annual percent changes are December to December. June 9, 1988
#Quarterly data are year-over-year percent changes.
a.r. = annual rate

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Economic Outlook

Irving Trust

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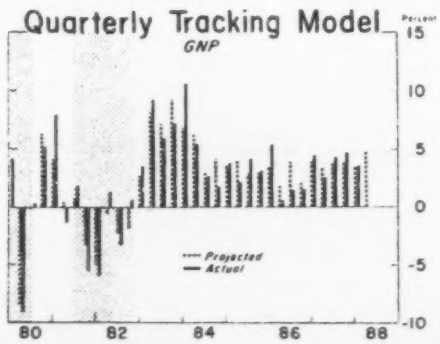
Planning Division

July 1988

The June employment numbers should lay to rest concerns that the economy slowed much in the second quarter. Instead, it appears that the basic strong growth trend established in early 1987 remains in force. The economy dipped slightly below this trend in the first quarter, as auto production dropped while dealers worked off excess inventories. But auto output rebounded sharply in the second quarter, suggesting that a pickup in GNP growth may surprise consensus forecasters, who have consistently underestimated the economy's strength during the past 18 months. Other statistics seem to confirm this pattern. The June purchasing managers' survey indicates the fastest growth since late last year when the economy was growing at a 4.8 percent pace. Under these conditions further increases in wage and price pressures are likely. While interest rate rises to date may hinder further acceleration in economic growth, they are probably not enough to slow the economy appreciably, given the strong business environment throughout the industrialized world.

Employment gains last month were widespread with both goods and services industries showing solid increases. In the manufacturing sector most of the additional jobs were in the durable goods sector, notably fabricated metals and machinery, which are major beneficiaries of business's capital spending spree. The Bureau of Labor Statistics diffusion index showed increases in about two-thirds of the industries surveyed, the greatest proportion so far this year. In addition to the good news on jobs, the wage inflation news was also favorable, with upward pressures moderating after some hefty increases earlier. But wage pressures should build if, as seems likely, strong employment growth continues this year. The aggregate hours index, which is arguably the best coincident indicator of economic growth, showed a strong increase in June and for the second quarter as a whole. Our GNP tracking model, which moves largely based on this indicator, predicts almost five percent growth for second quarter GNP (See chart).



Our official output forecast is about a percent lower, however, as a larger than usual proportion of the hours increase was attributable to younger workers, who are typically less productive than average.

Growing levels of imports and exports are spurring healthy gains in those economic sectors responsible for distributing tradable goods through the economy. Vendor performance, which measures the percentage of companies reporting slower deliveries, reached 70 in June, the highest level of the

year. An index of rail freight prices, which was flat from 1984 through 1987, is increasing at a double-digit annual rate so far this year. Strong export demand has pushed capacity utilization to the highest level since 1980. The purchasing managers' report focused attention on some of these potential inflation "hotspots" including longer lead times and shortages of some basic materials. Price pressures are still building in the producer pipeline where primary and intermediate goods prices are increasing about twice as fast as final goods prices. The strong conditions reported by the purchasing managers are in sharp contrast to the growth forecast given by Alan Greenspan in his Humphrey-Hawkins testimony. The Fed forecast implies a significant slowdown in economic growth during the last half of 1988. There is, however, little evidence of a slowdown in the leading indicators for June, which will most likely show a sizable increase. As the Fed chairman emphasized, inflationary pressures will tend to increase unless the economy slows from its recent pace.

All things considered, it seems unlikely the economy will slow in line with Fed expectations. Instead, it looks like the basic pattern of strong export and investment demand, mixed with modest consumer demand growth, will continue. As long as the labor market remains strong, it is unlikely consumers will cut back. Rising rates will damp housing starts, but it is hard to see how 1988 growth will drop below three percent without a heavier step on the brakes.

Robert T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual 1987 II	1987 III	1987 IV	1988 I	Forecast 1988 II	1988 III	1988 IV	1989 I	Actual 1986-1987	Forecast 1987-1988	Forecast 1988-1989
Consumer Spending	1.2	3.5	-1.7	2.4	1.6	1.1	0.9	0.8	1.3	1.3	0.8
Business Investment	1.3	2.8	0.2	2.4	1.6	0.9	0.8	0.7	0.1	1.5	1.1
Residential Investment	-0.2	-0.4	0.4	-0.5	-0.1	-0.1	-0.1	-0.2	0.0	-0.1	-0.2
Change in Inventories*	-1.6	-1.5	4.9	-2.0	0.1	0.3	0.4	0.5	0.4	0.2	0.0
Net Exports	0.3	-0.6	0.3	1.6	0.4	0.7	0.7	0.8	0.3	0.6	0.6
Government Purchases*	1.5	0.5	0.7	-0.3	0.3	0.3	0.3	0.3	0.8	0.3	0.4
Real GNP	2.5	4.3	4.8	3.6	3.9	3.2	3.0	2.9	2.9	3.8	2.7

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual 1987 II	1987 III	1987 IV	1988 I	Forecast 1988 II	1988 III	1988 IV	1989 I	Actual 1986-1987	Forecast 1987-1988	Forecast 1988-1989
Nominal GNP	6.3	7.3	7.3	5.1	7.7	8.0	8.2	8.4	6.0	7.0	8.3
GNP Deflator	3.5	2.8	2.7	1.4	3.8	4.6	5.0	5.4	3.0	3.0	5.4
Corporate Profits After Tax#	10.0	9.0	8.7	11.8	10.4	7.2	6.7	6.4	8.4	9.2	6.4

Monthly Economic Indicators

	Recent Data Apr.	May	June	Actual 1987	Forecast 1988	1989
Consumer Price Index** (%)	0.4	0.3	n.a.	4.4	4.8	6.4
Industrial Production (%)	0.5	0.5	0.4	3.7	5.2	3.0
Retail Sales (%)	-0.5	0.3	0.5	5.1	5.4	5.2
Auto Sales (million units, a.r.)	10.5	10.2	10.6	10.3	10.3	8.8
Housing Starts (million units, a.r.)	1.58	1.38	1.45	1.63	1.45	1.35
Unemployment Rate (%)	5.4	5.6	5.3	6.2	5.4	5.2
Merchandise Trade Balance ($ bn., a.r.)	-123.6	-131.2	n.a.	-171.2	-145.0	-110.0

*Adjusted for CCC purchases. **Annual percent changes are December to December. July 19, 1988
#Quarterly data are year-over-year percent changes.
a.r. = annual rate

Economic Outlook

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Irving Trust

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Economic Research & Planning Division

August 1988

The U.S. economic expansion is approaching its sixth birthday with a full head of steam. The Commerce Department reported second-quarter GNP growth at a 3.1% annual rate in its advance estimate. Even more striking was an upward revision to 1987 growth, which now stands at a very strong 5% pace, compared with the 4% rate originally reported. The bad news is that inflation picked up sharply in the second quarter with the GNP price index rising 4.7%, compared with 3.5% in the first. Labor cost measures recently released also show an accelerating tendency (see chart), which is not too surprising given the developing imbalances between labor supply and demand. The Federal Reserve is trying to douse the spreading sparks of inflation with higher interest rates. But rising incomes, profits and confidence are adding more oxygen as the inflationary embers glow with a growing intensity.

Moderate second-quarter GNP growth masked another quarter of 5%-plus growth in real final sales. Strength in final demand was across the board, including another round of large contributions by consumers, businesses, and foreigners. The Commerce Department reported that drought-related problems in the agricultural sector reduced second-quarter output by about a half percent. Another area of weak growth was the government sector, which has made little contribution to economic growth so far this year.

The employment report for July was quite strong, showing good growth across a wide spectrum of industries. Payroll employment grew by 285,000, following an upward revised increase of 532,000 jobs in June. Over the past year almost 4 million jobs have been created according to the payroll survey, compared with about 2.5 million in the household survey. Part of the discrepancy arises because a person with two jobs is counted twice in the payroll survey, but only once in the household survey. This increase in multiple job holding suggests further economic growth will be hampered by labor shortages and wage inflation. Another effect of scraping the bottom of the labor barrel is falling productivity. Nonfarm labor productivity plunged 1.7% in the second quarter, as unit labor costs soared at a 5.9% annual rate.

The Federal Reserve's Tan Book Survey of regional economic conditions for the August 16 FOMC meeting reports continued economic expansion at a moderate to strong pace in all but two of the 12 districts. The survey notes tight labor market conditions in some areas. It also finds that "capacity constraints and shortages have developed in some districts and materials price increases are

widespread." The survey does identify some pockets of weakness, including certain building materials industries, military expenditures, agriculture, apparel sales, and excess inventories of imported motor vehicles. A good bit of apparel is imported, and consumers have balked at sharp price increases stemming from the dollar's decline. Imports of cars and especially trucks have also met with price resistance, causing a rise in domestic producers' share of the overall vehicle market this year. The weakness in building materials is mixed. Overall construction spending is still growing with a surge in non-residential construction more than offsetting a drop in residential construction. Industrial construction is up 20% over the past year as businesses expand capacity. The purchasing managers' report on July business conditions confirms the Tan Book view that the economy is continuing to grow at a good pace in the third quarter.

The latest indicators paint a picture of an economy growing at better than a 3.5% rate, which is too fast for an expansion this old. Price increases will spread as capacity is strained in more and more sectors. Wage increases are likely to continue their upward trend. Fortunately, strong capital spending is adding new capacity and foreign competition will help restrain price increases, while higher interest rates will help restrain domestic demand. But the expansion will still be breathing quite a bit harder next year at its seventh birthday party.

Robert T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual				Forecast				Actual	Forecast	
	1987		1988		1988		1989		1986-	1987-	1988-
	III	IV	I	II	III	IV	I	II	1987	1988	1989
Consumer Spending	3.0	-1.4	2.9	1.5	1.3	1.2	1.1	0.8	1.8	1.5	1.0
Business Investment	3.0	0.2	0.9	1.6	1.3	1.2	1.1	1.0	0.3	1.3	1.1
Residential Investment	-0.6	0.0	-0.3	0.1	-0.1	-0.2	-0.2	-0.2	0.0	-0.1	-0.2
Change in Inventories*	-1.0	6.3	-2.0	-1.9	0.2	0.2	0.1	0.2	0.2	0.1	0.1
Net Exports	-0.5	0.5	1.7	1.9	0.7	0.6	0.6	0.6	0.2	1.0	0.7
Government Purchase*	0.6	0.5	0.2	-0.1	0.3	0.3	0.3	0.3	0.9	0.3	0.3
Real GNP	4.5	6.1	3.4	3.1	3.7	3.3	3.0	2.7	3.4	4.1	3.0

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual				Forecast				Actual	Forecast	
	1987		1988		1988		1989		1986-	1987-	1988-
	III	IV	I	II	III	IV	I	II	1987	1988	1989
Nominal GNP	7.7	8.6	5.4	7.2	8.6	8.5	8.6	8.8	6.8	7.4	8.6
GNP Deflator	3.1	2.4	1.7	4.1	4.6	5.0	5.4	5.9	3.3	3.1	5.4
Corporate Profits After Tax#	12.7	5.7	10.3	9.3F	8.4	7.8	7.4	6.3	10.2	8.9	6.4

Monthly Economic Indicators

	Recent Data			Actual	Forecast	
	May	June	July	1987	1988	1989
Consumer Price Index** (%)	0.3	0.3	n.a.	4.4	4.8	6.3
Industrial Production (%)	0.5	0.4	n.a.	3.7	5.2	3.0
Retail Sales (%)	0.3	0.5	n.a.	5.1	5.4	5.2
Auto Sales (million units, a.r.)	10.4	11.0	10.7	10.3	10.3	9.3
Housing Starts (million units, a.r.)	1.38	1.45	n.a.	1.63	1.45	1.35
Unemployment Rate (%)	5.6	5.3	5.4	6.2	5.4	5.2
Merchandise Trade Balance ($ bn., a.r.)	-131.2	n.a.	n.a.	-171.2	-145.0	-110.0

*Adjusted for CCC purchases. **Annual percent changes are December to December. August 10, 1988
#Quarterly data are year-over-year percent changes.
a.r. = annual rate F = forecast

Economic Outlook

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Economic Research &
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September 1988

Economic activity probably slowed in August, most likely because of the heat and drought rather than the effects of tighter monetary policy. At current levels, interest rates are unlikely to exert enough restraining influence to bring economic growth down to the 2.0-2.5% range that the Federal Reserve believes is compatible with less inflation. Tighter monetary policy does appear, however, to have reduced optimism about the growth outlook according to the Federal Reserve's latest survey of economic conditions. Nevertheless, a careful look at recent statistics indicates scant evidence for a sustained slowdown from the 3.3% pace of the first half. The combination of strong statistics in June and July and one of the hottest summers in recent memory make the August statistics look weaker than the economy's underlying growth trend. Production should bounce back from the August doldrums as the effects of hot weather and the drought recede into history. Until evidence of economic strength re-emerges, reduced fears of Fed tightening should bolster business confidence and pave the way for additional output gains.

The employment report for August caused a sharp shift in sentiment, hinting to some analysts that a major cooling off may have begun. Payroll employment was up by 219,000, about as expected, but as has so often been the case, the market shaking news was in other parts of the report. Most notably, there was a sharp fall in the average work week. At least part of the drop is a result of the hot weather and attendant adverse working conditions. There were scattered reports of workers walking out of plants because of severe heat. It also seems reasonable that outdoor work was curtailed in the scorching August weather to avoid physical harm to workers. In addition, the drought had a negative impact on seasonal vegetable harvesting and food processing employment, especially in the Midwest.

The financial markets also took comfort from a sharp downward revision to the July payroll employment increase which was reduced from 283,000 to 200,000. Two factors seem to explain most of this adjustment. First, about 30,000 new jobs were added to the revised June payroll figure, thus reducing the July increase. Second, the revision to the July number was largely due to a reduction in local government employment. Neither of these factors are convincing evidence of a slowdown in the private sector. One indisputable piece of good news on the inflation front was the slight rise in the index of average hourly earnings. But again this is one month's number following some large increases. With initial claims for unemployment insurance remaining quite low and consumer confidence quite high, it seems premature to write off the possibility of building wage inflation.

While the latest Federal Reserve survey of regional conditions found less optimism about the outlook, it still found the pace of business activity through late August relatively unchanged from earlier surveys, with weakening conditions noted only in the St. Louis district. The softness in the midwest economy clearly reflects the adverse summer weather conditions with employment declines particularly severe in the mining, construction, and food processing industries. In contrast, "many chemicals producers, saw mills, and paper manufacturers, are running at maximum capacity due to a rapid increase in exports and strong domestic sales." Overall the Tan book suggests little

change in economic conditions from earlier this year and it supports the idea that new signs of weakness are largely weather-related. As a result, the lagging St. Louis district is likely to show a rebound in the next few months.

Inflation remains a concern throughout the country. The Fed report summarizes the price situation as follows: "Rising raw materials costs continue widespread, and higher prices for components are increasingly being noted. Further price increases are expected." The purchasing manager's report also found price pressures to continue in August but at a slightly lower pace than in earlier months. In particular, "price increases in metals appear to be abating but drought related increases seem to be taking their place." Overall, the purchasing manager's index slipped to 56.2% in August from 59.0% in July. Coming on the heels of the weak August employment report, this was taken as additional evidence that the economy was slowing. However, the index remains at a level that has been consistent with 3.7% growth in the past, a growth rate that is substantially above the Federal Reserve's estimate of what is consistent with non-inflationary growth.

Excluding the farm sector, real output expanded at a robust 4.7% rate in the second quarter. Drought related losses will continue to reduce output growth over the next few months. While the statistics for August may herald a more sustained slowdown in U.S. economic growth, it seems premature to draw such a conclusion until the ripple effects of the drought have passed through the economy.

Robert. T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual				Forecast				Actual	Forecast	
	1987		1988		1988		1989		1986-	1987-	1988-
	III	IV	I	II	III	IV	I	II	1987	1988	1989
Consumer Spending	3.0	-1.4	2.9	1.8	1.3	1.2	1.1	0.8	1.8	1.6	1.1
Business Investment	3.0	0.2	0.9	1.8	1.3	1.2	1.1	1.0	0.3	1.4	1.1
Residential Investment	-0.6	0.0	-0.3	0.1	-0.1	-0.2	-0.2	-0.2	0.0	-0.2	-0.2
Change in Inventories*	-1.0	6.3	-2.0	-2.8	0.2	0.2	0.1	0.2	0.2	-0.1	0.0
Net Exports	-0.5	0.5	1.7	1.9	0.7	0.6	0.6	0.6	0.2	1.0	0.7
Government Purchase*	0.6	0.5	0.2	0.5	0.3	0.3	0.3	0.3	0.9	0.5	0.3
Real GNP	4.5	6.1	3.4	3.3	3.7	3.3	3.0	2.7	3.4	4.2	3.0

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual				Forecast				Actual	Forecast	
	1987		1988		1988		1989		1986-	1987-	1988-
	III	IV	I	II	III	IV	I	II	1987	1988	1989
Nominal GNP	7.7	8.6	5.4	8.3	8.6	8.5	8.6	8.8	6.8	7.6	8.6
GNP Deflator	3.1	2.4	1.7	5.1	4.6	5.0	5.4	5.9	3.3	3.3	5.5
Corporate Profits After Tax#	12.7	5.7	10.3	18.1	9.6	8.9	7.5	5.8	10.2	11.7	6.4

Monthly Economic Indicators

	Recent Data			Actual	Forecast	
	June	July	Aug.	1987	1988	1989
Consumer Price Index** (%)	0.3	0.4	n.a.	4.4	4.8	6.3
Industrial Production (%)	0.4	0.8	n.a.	3.7	5.2	3.0
Retail Sales (%)	0.4	0.5	n.a.	5.1	5.4	5.2
Auto Sales (million units, a.r.)	11.0	10.7	10.6	10.3	10.3	9.3
Housing Starts (million units, a.r.)	1.45	1.49	n.a.	1.63	1.45	1.35
Unemployment Rate (%)	5.3	5.4	5.6	6.2	5.4	5.2
Merchandise Trade Balance ($ bn., a.r.)	-150.5	n.a.	n.a.	-171.2	-145.0	-125.0

*Adjusted for CCC purchases. **Annual percent changes are December to December.

#Quarterly data are year-over-year percent changes.

a.r. = annual rate

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Economic Outlook

Irving Trust

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October 1988

The economic statistics continue to paint a mixed picture of economic strength. Employment growth has slowed down after a strong showing early in the summer, while business orders and sales have remained relatively healthy. The trade statistics suggest a moderation in the robust pace of export growth and hint that import growth may be picking up again. Unemployment remains quite low and initial claims for unemployment insurance are still around the lowest levels of the past 15 years. The Commerce Department has announced that drought effects will reduce GNP growth by .5% in the third quarter and 1.5% in the fourth quarter, after trimming second quarter growth by almost a full percentage point. All tolled, the drought will take a substantial three-fourths percentage point off 1988 growth. Nevertheless, output continues to grow at a robust pace.

The government is easing planting restrictions next year to help farmers rebuild low grain inventories. If the weather cooperates, next year should see a hefty addition to output growth from the farm sector. As a result, our forecast now reflects the slowdown effects of the drought through year-end and a significant pickup next year from an unusually strong planting season. Rather than the smooth deceleration of our earlier outlook, we now expect a somewhat greater initial slowdown with a pickup in early 1989 before the economy moves onto the slower growth track that the Federal Reserve desires to avoid any further worsening in inflation. The year-end drought effects suggest that the Fed and the markets may be lulled into thinking that the Fed's tightening to date is doing the job.

	Real Final Sales*	Real GNP
1986	2.7	2.0
1987	3.4	5.0
1988	5.7	3.1

* QIV-QIV percent changes, except 1988 first half growth.

But real final sales remain too high for output growth to stay below 3% on a sustained basis (See table). The pickup in first-half 1989 output is likely to rekindle Fed and market concern about inflation and the unsustainable pace of economic growth. Consequently, the outlook assumes monetary policy will remain in a firming posture. Because sales increases have exceeded production growth, inventories show no signs of overbuilding at this stage of the expansion. Strong third quarter inventory accumulation has been matched by healthy business sales so that the inventory sales ratio remains unchanged at 1.50. Since excess inventories are one warning sign of impending recession, these statistics suggest little likelihood of a recession anytime soon. In fact, car inventories entered the new model year in the best shape in recent years, prompting larger-than-usual price increases in the new models.

The September employment report presented a mixed picture of the economy. Payroll employment increased by a respectable 255,000 jobs. A large part of the increase, however, was due to an unusually big seasonal pickup in new

teachers jobs. In addition, the growth in August employment was revised down substantially. Employment in the manufacturing sector decreased for the second month in a row, leading some observers to herald the end of the two-year old industrial recovery. Nevertheless, the length of the factory workweek and overtime bounced back in September and stand at high levels normally associated with robust production. Strong factory orders also suggest that reports of the industrial expansion's demise are greatly exaggerated. Continued signs of growing capital spending support this view. Overall, the index of aggregate weekly hours for the third quarter suggests economic growth well above 3%. Furthermore, the unemployment rate dropped back down to 5.4% and wage growth picked up to higher earlier levels, suggesting a continued risk of overheating in the labor market. It is difficult to see how wage growth will fall off in an environment where job growth continues to exceed the growth in the labor force.

One danger in the latest numbers is the relative shift toward stronger domestic demand compared with foreign demand for U.S. output. The dollar has weakened as the markets have sensed this shift. Given a choice between domestic and foreign demand, the Fed would obviously prefer to see the latter grow faster to improve the U.S. balance of payments. A slowdown in U.S. growth due to a stalling trade improvement and drought-induced output losses is more inflationary than a slowdown from declining domestic demand. Until domestic demand growth moderates significantly, the economy will continue to have an inflationary bias.

Robert T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual				Forecast				Actual	Forecast	
	1987		1988		1988		1989		1986-	1987-	1988-
	III	IV	I	II	III	IV	I	II	1987	1988	1989
Consumer Spending	3.0	-1.4	2.9	1.9	1.6	1.3	1.3	1.1	1.8	1.7	1.2
Business Investment	3.0	0.2	0.9	1.7	1.3	1.1	1.1	1.0	0.3	1.3	1.1
Residential Investment	-0.6	0.0	-0.3	0.0	-0.1	-0.2	-0.2	-0.2	0.0	-0.2	-0.2
Change in Inventories*	-1.0	6.3	-2.0	-2.8	0.1	-0.3	0.3	1.0	0.2	-0.1	0.2
Net Exports	-0.5	0.5	1.7	1.7	0.3	0.3	0.3	0.2	0.2	0.9	0.4
Government Purchase*	0.6	0.5	0.2	0.5	0.3	0.3	0.3	0.3	0.9	0.4	0.3
Real GNP	4.5	6.1	3.4	3.0	3.5	2.5	3.1	3.4	3.4	4.0	3.0

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual				Forecast				Actual	Forecast	
	1987		1988		1988		1989		1986-	1987-	1988-
	III	IV	I	II	III	IV	I	II	1987	1988	1989
Nominal GNP	7.7	8.6	5.4	8.7	8.1	7.6	8.7	9.5	6.8	7.5	8.7
GNP Deflator	3.1	2.4	1.7	5.5	4.6	5.0	5.4	5.9	3.3	3.4	5.5
Corporate Profits After Tax#	12.7	5.7	10.3	18.1	9.6	8.9	7.5	5.8	10.2	11.7	6.4

Monthly Economic Indicators

	Recent Data			Actual	Forecast	
	July	Aug.	Sept.	1987	1988	1989
Consumer Price Index** (%)	0.4	0.4	n.a.	4.4	4.8	6.3
Industrial Production (%)	1.2	0.2	0.0	3.7	5.5	3.0
Retail Sales (%)	0.5	-0.1	-0.4	5.1	5.7	5.2
Auto Sales (million units, a.r.)	10.7	10.6	10.6	10.3	10.7	9.8
Housing Starts (million units, a.r.)	1.49	1.44	n.a.	1.63	1.45	1.35
Unemployment Rate (%)	5.4	5.6	5.4	6.2	5.5	5.2
Merchandise Trade Balance ($ bn., a.r.)	-114.0	-146.4	n.a.	-171.2	-145.0	-125.0

*Adjusted for CCC purchases. **Annual percent changes are December to December. October 17, 1988
#Quarterly data are year-over-year percent changes.
a.r. = annual rate